

Can Foreign Aid Help to Promote Institutional Changes? An assessment of Poverty Reduction Support Credits in Vietnam¹

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Abstract: This paper examines the relationship among foreign aid, conditionality, and institutional changes through an assessment of several Poverty Reduction Support Credits in Vietnam. We find that the Vietnamese government's political commitment to its accession and compliance to the WTO has created strong incentives for various institutional changes in property rights, investment climate, and public service provision in Vietnam after 2000, which in turn lead to the second wave of FDI inflow and growth. These institutional reforms have been institutionalized in the government structure as a mechanism functioning to coordinate various political and governmental groups. Foreign aid such as PRSCs themselves has not created a strong incentive for these changes, rather provided guidance and specific menus for such strongly country owned institutional reforms.

JEL:

Key words: foreign aid, country ownership, conditionality, institution, economic reform

1. Introduction

The importance of governance and institutions in economic development has received increasing attention among economists, political scientists, and aid practitioners. One of the prominent advocates of “new institutional economics”, Professor Acemoglu noted in a small booklet of the World Bank,

There is now a growing understanding that economic, political, legal, and social

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“institutions” are essential to the economic success and failure of nations. ...In the context of economic growth and development, governance refers to essential parts of the broad cluster of institutions. Particularly important elements of governance, defined as such, would include the political institutions of a society (the process of collective decision-making and the checks on politicians, and on politically and economically powerful interest groups), state capacity (the capability of the state to provide public goods in diverse parts of the country), and regulation of economic institutions (how the state intervenes in encouraging or discouraging economic activity by various different actors).(p.1 in Acemoglu 2008)

If institutions are of such importance, next natural question is how we can change the institutions to facilitate development. Aid practitioners are normally optimistic to believe that foreign aid can promote institutional changes. Some economists were also optimistic for the transplantation of legal, regulatory regime and other institutions (Djankov, Glaeser, La Porta, Lopez-de-Silanes and Shleifer, 2003). Acemoglu, however, negatively responded to such optimism stating, “exporting good economic institutions is as hopeless as exporting democracy,” in the above-mentioned article. Rodrik (2006) echoed this pessimism to institutional changes by pointing out several findings that even countries committing to reform stopped short of undertaking the full gamut of institutional changes, which were needed to create well-functioning market economies. He stated that the obsession with undertaking comprehensive institutional reform leads to a policy agenda that is hopelessly ambitious and virtually impossible to fulfill. The view expressed by Rajan and Subramanian (2007) was worse. They showed that countries that receive more aid see a more negative impact in manufacturing sectors that are more governance-sensitive. They concluded that aid might be particularly associated with weakened governance because aid inflows reduce the need for governments to tax the governed or enlist their cooperation, which undermines the competitiveness of manufacturing sector through Dutch disease effects. Poverty Reduction Support Credits (PRSCs) were introduced by the World Bank in 2001 to support IDA countries in implementing their Poverty Reduction Strategy Papers (PRSPs). The main objective of PRSPs was to assist IDA countries to improve the poverty impact of public policy and expenditures by promoting more effective changes for reform than those of Structural Adjustment Programs in 1990s. The PRSC, an approach to development policy lending (DPL), was provided in the form of policy-based, non-project financing, general budget support that is typically annual, with medium-term timeframe, and based on progress in achieving the objectives of the government’s PRSP. The PRSP was based on four principles – country ownership, comprehensiveness and long-term perspective, results orientation, and partnership. The PRSP country governments were supposed to take strong leadership role to set the policies, programs, and budget in the PRSCs in line with the principle of country ownership (World Bank 2005). The PRSCs reflect several recent trends in the international aid architecture: shift from project support, shift from ex-ante conditionality to a partnership based approach, emphasis on country ownership, systems and capacity, shift to

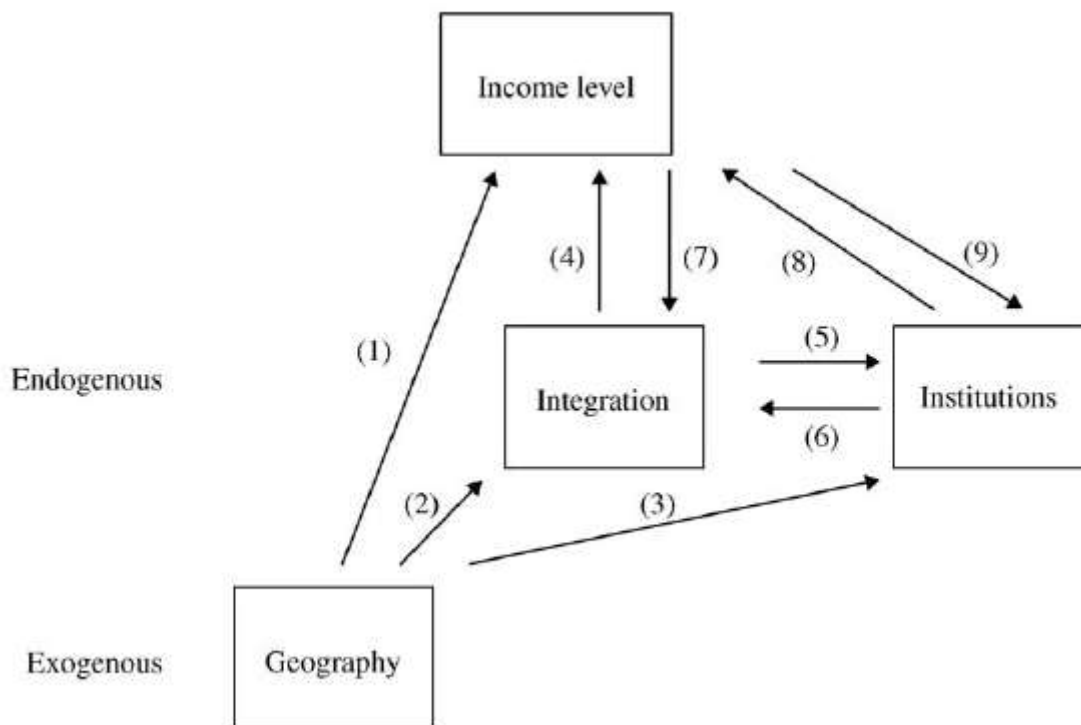
medium-term reforms, recognition of the predictability of aid, selectivity, focus on development results, and scaling up (a concise survey is provided by Paul (2006)). PRSP strongly wishes to address key cross-cutting issues, especially governance. It seems widely believed among aid practitioners that country owned PRSCs can promote to improve governance and to facilitate a process of political changes that shifts the balance of power among domestic stakeholders (Koeberle and Stavreski, 2006).

The objective of our paper is to check the relationship among foreign aid, conditionality, and institutional changes through an assessment of PRSCs in Vietnam. The period coverage of this assessment is longer than short-term PRSC implementation period because the institutions are impossible to change in short-term. Since institutional changes are strongly dependent on historical context, we are not able to implement a rigorous “natural experiment” to evaluate the impact of the PRSCs to institutions. Rather we examined the process of institutional changes and the PRSCs in detail and found that Vietnamese government’s political commitment to its accession and compliance to the WTO has created strong incentives for various institutional changes in property rights, investment climate, and public service provision in Vietnam². The Vietnamese government’s main driving force for reform is its strong desire to achieve significant status in the international community, which has been embodied in its WTO accession and compliance, which was achieved in early 2007. In fact, PRSC policy actions (conditionality) have been consistent with WTO compliance. Therefore, the PRSCs may well be considered as one of the available tools to support Vietnam’s WTO compliance.

Rodrik (2003), Rodrik, Subramanian and Trebbi (2004) illustrated the relationship among the deeper determinants of growth, i.e., geography, integration by trade and institutions in **Figure 1**. The question is how the PRSCs in Vietnam influenced or not influenced the two endogenous variables of integration and institutions. How is the government’s ownership to implement such reforms? What factors motivated and contributed to the country’s transformation from the socialist planning type economy to the market based economy? We argue that these institutional reforms have been institutionalized in the government’s structure as a mechanism functioning to coordinate various political and governmental groups in Vietnam. Foreign aid such as the PRSCs themselves has not created a strong incentive for these changes, rather provided guidance and specific menus for such strongly country owned institutional reforms.

² Our argument for macro reform of Vietnam’s institutions is interestingly consistent with micro reform of institutions, land titling reported by Kim (2007). She empirically reported by hedonic model that looser political institutions and rapid growth of market by integration in Ho Chi Min City ironically created more incentives for land owners in HCMC to register their land title for establishing private property rights.

Figure 1 The deep determinants of income



Sources: Rodrik (2003), Rodrik, Subramanian and Trebbi (2004)

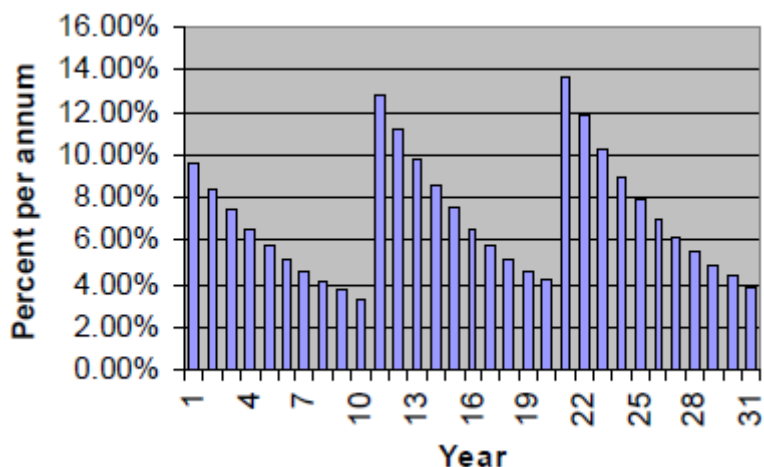
The remainder of the paper is organized as follows. In Section 2, we briefly summarize the PRSCs in Vietnam and existing studies of the PRSCs in Vietnam. Section 3 presents our assessment of the PRSCs. Section 4 concludes.

2. Poverty Reduction Support Credits in Vietnam

The Vietnamese government has promoted a policy of openness toward other countries ever since the adoption of the *Doi Moi* policy in 1986. The government has been promoting economic growth and poverty reduction through further development of market economy and integration into the international economy. Pritchett (2003) expressed that Vietnam’s growth episode until 1997, the time of Asian crisis, was a basic “escape from poverty” trap transition followed by a “Tarzan of the Jungle” series of growth (Figure 2), in which Vietnam had been able to maintain rapid growth by staying on the series of transition. Vietnam has successfully become a WTO member in January 2007. We argue that this accession to WTO was Vietnam’s another swing to the next vine³. But how they swung to that vine?

³ Hill (2000) reported the success of market reform by trade liberalization in Vietnam before 1997.

Figure 2 Pritchett's "Tarzan of the Jungle" economy concept of evolution of output



Source: Pritchett (2003)

The Vietnamese government has formulated the Comprehensive Poverty Reduction and Growth Strategy (CPRGS) in May 2002, and has been addressing its policy agenda, which includes state-owned enterprise (SOE) reform, private sector development, financial sector reform, further transition to a market economy and integration into the global economy, policy improvements and capacity enhancement in social sectors such as education and health, and strengthening of administrative reform and governance.

As a framework to support the CPRGS, the World Bank has been extending Poverty Reduction Support Credits (PRSCs) to Vietnam. The Japanese government had joined this framework since PRSC3, with concrete policy messages in relation to the "expansion"⁴ of the CPRGS as well as Japan-Vietnam Joint Initiative.⁵ The former had close link with policy issues related with developing large-scale infrastructures, and the latter with issues in improving the business climate in Vietnam. As such, Japanese government and Japan Bank for International Cooperation or JBIC, a loan aid agency of Japanese Government have attached particular weight to (1) improvement of public financial management through resource allocation mechanisms of CPRGS, and (2) investment promotion and improvement of business climate. For the succeeding PRSCs 4 and 5, the Japanese government has added (3) financial sector reform and (4) SOE reform to Japan's priority areas. The Japanese government and JBIC have continued to collaborate actively, make adjustments in and contribute to the policy dialogue among the Vietnamese government, the World Bank and other donors.

The objective of the PRSC program was to address the policy challenges articulated in the

⁴ In response to the proposal made by the Japanese government, the Vietnamese government has added a new chapter on the role of large-scale infrastructure to the CPRGS.

⁵ A bilateral initiative to improve Vietnam's business environment with the aim to strengthen competitiveness.

CPRGS and summarized as (1) transition to a market economy, (2) social inclusion and environmental sustainability, and (3) building modern governance by supporting various reforms undertaken by the Vietnamese government, and thereby contribute to poverty reduction and economic growth of Vietnam (see **Table 1**). As for Japan and JBIC, particular emphasis has been put on the areas of public financial management, development of investment and business environment, and reform of SOEs and financial sector.

Table 1 PRSC reform areas

| Pillars | Reform areas |
|---|---|
| (1) Transition to a Market Economy | Trade integration, SOE reform, financial sector reform, private sector development, infrastructure |
| (2) Social Inclusion and Environmental Sustainability | Education, health, social protection, land and forests, water, environment, gender |
| (3) Building Modern Governance | Planning process, public financial management, financial accountability, legal development, public administration reform, anti-corruption, information availability |

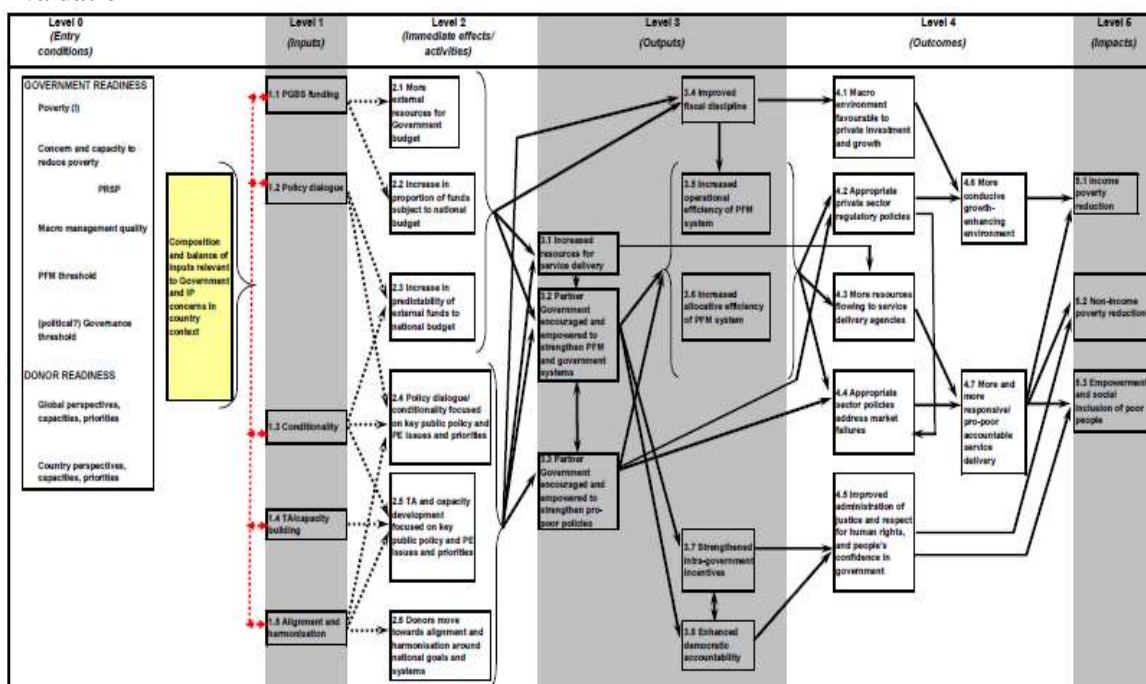
Five assessments of the PRSCs in Vietnam by different donor agencies have been implemented.

- a) Quality at Entry Panel (for PRSC 2) by the World Bank
- b) Joint Donor Evaluation (by PRSC 4) by OECD DAC
- c) Implementation Completion and Results Report (for PRSC1-5) by the World Bank
- d) Mokoro Report (after PRSC 5) by DfID of UK
- e) Currently on-going initiative by Independent Evaluation Group of the World Bank (by PRCS 6)

We utilized all the reports for our assessments even there were considerable varieties of conclusions within these assessments. Of the above, “b) Joint Donor Evaluation” was conducted under the initiative of the OECD DAC as part of its Joint Evaluation of General Budget Support covering 7 countries⁶ including Vietnam. This independent evaluation was based on consultations with the World Bank, relevant donors and key government counterparts. Our assessment has taken advantage of the evaluation methodology of this Joint Donor Evaluation. **Figure 3** provides an overview of the Enhanced Evaluation Framework (EEF) that the Joint Donor Evaluation has specially developed to carry out its evaluation (Joint Donor Evaluation Report (2006)).

⁶ Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda and Vietnam

Figure 3 Causality Map for the Enhanced Evaluation Framework for Joint Donor Evaluation



Source: Joint Donor

Evaluation Report (2006)

Some of the key features of the EEF are: adoption of the five standard evaluation criteria of the OECD DAC, creation of a logical framework depicting the possible sequence of effects of General Budget Support (GBS), allowing them to be systematically tested, incorporation of “Level 0” in the logical framework, showing the entry conditions (i.e. the circumstances in which GBS is introduced) for GBS, conceiving three main types of effect – flow-of-funds effects, institutional effects and policy effects – in GBS, and paying particular attention to monitoring and feedback effects at all levels of the framework.

“c) Implementation Completion and Results Report of PRSC1-5” by the World Bank (Report No: ICR0000483, June 29, 2007) and series of its Program Documents have also been fully utilized for our assessment. The report noted that outcomes of all of the PRSC operations in Vietnams were rated “satisfactory” and the PRSC process has contributed substantially to the capacity of the government to conduct cross-sectoral policy dialogue, resulting that the government has become more receptive to sharing policy drafts at an early stage and eliciting feedback from relevant stakeholders (World Bank 2007).

Although the coverage of the PRSCs in Vietnam is very broad, we would concentrate our analysis for the coverage areas of Japan and JBIC, public financial management, development of investment and business environment, and reform of SOEs and financial sector, since the objective of our analysis is to find a relationship between foreign aid and institutional changes with a

particular emphasis on trade relationship in the next section.

3. An assessment of the PRSCs in Vietnam

Figure 4 shows the PRSC logical framework focusing on Japan/JBIC’s priorities of the PRSC reform areas. We apply the OECD DAC’s five evaluation criteria utilizing the logical framework which consists of following items:

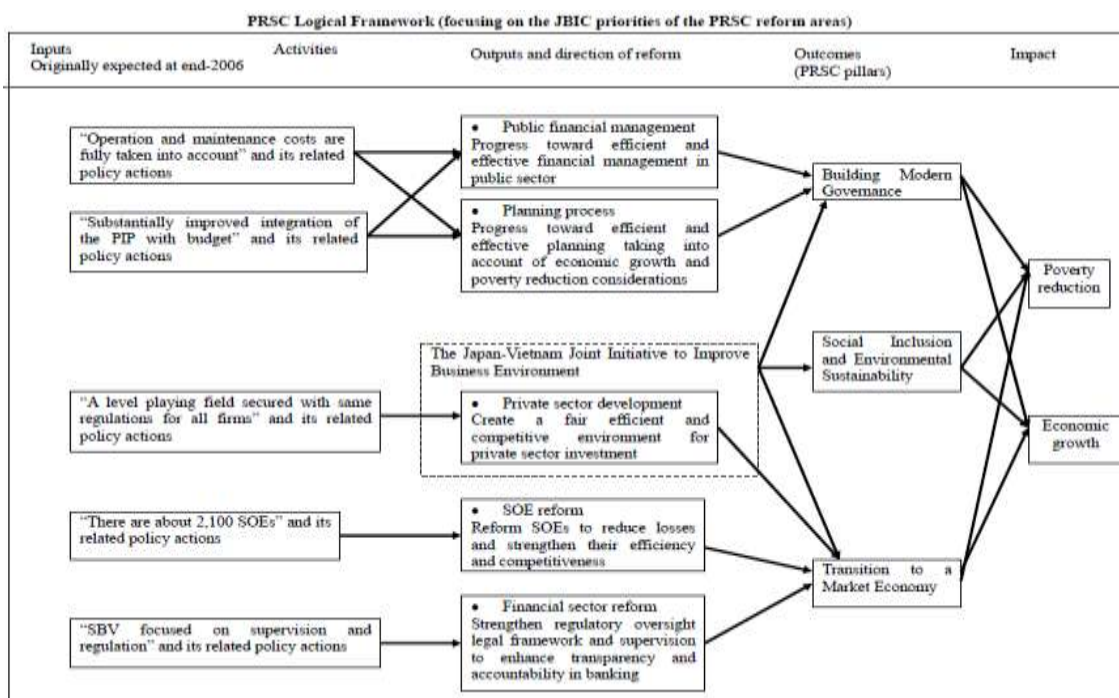
Inputs and activities: PRSC funding, policy dialogues, conditionality, technical assistance/capacity building, donor coordination.

Outputs: Among the PRSC reform areas, JBIC ex-post evaluation has focused on the following five areas: public financial management, planning process, private sector development, SOE reform, financial sector reform (Refer to Table 5 for the Operation and Effect Indicators in respective reform areas that JBIC has identified during the preparation for PRSC3, 4 and 5.)

Outcomes: Three pillars of the PRSC – (1) Transition to a Market Economy, (2) Social Inclusion and Environmental Sustainability, (3) Building Modern Governance

Impact: Vietnam’s poverty reduction and economic growth

Figure 4 PRSC Logical Framework (focusing on the JBIC priorities of the PRSC reform areas)



Relevance: Strong Ownership

The first criteria we apply for our assessment is the relevance of the programs. We evaluate that PRSC has been highly relevant with Vietnam’s national policies from the time of commitment upto

now. The PRSC aims to support the CPRGS and the government's reform programs. Due attention should be paid that PRSC policy actions are in line with its WTO compliance, which implies that the Vietnamese government, with its strong political commitment and determination, has been utilizing another framework (i.e. aid instrument) to push forward its reform process.

The implementation of State Owned Enterprises (SOEs) reform and financial sector reform gave supporting evidences for such relationship. In the process of transition to market economy, these two sectors have often created major impediments to reform since these two sectors have played a key mechanism during the socialist economy era and have closely related with the interests of line ministries. The government's reform initiatives to integrate with the world economy have endeavored to block vested interests and such strong resisting force. Even so, there still remain problems such as existence of many non-performing SOEs and slow implementation of financial sector reform. **Table 2** shows that decreasing but many non-performing SOEs are still in operation because of such inertia. The Implementation Completion and Results Report of the World Bank confirmed the relationship.

Integration with the world economy is being used as a mechanism to "lock-in" the reforms, and gradually create the incentive for changes in areas where the inertia is stronger. Accordingly, as WTO accession neared the final stage, a much broader approach to reform in the banking sector was finally adopted, and a new approach to SOE emerged (p.30, World Bank (2007))

As such, we would consider that PRSC itself has not created incentive for reform but it has provided the government with relevant milestones and guidance to achieve the country's development vision and goals. Such strong motivation has come from within the government itself, not something being imposed from donors or other outside parties.

Table 2 SOE performance in 2005

| | SOEs | Limited Liability | Public service | Joint stock | Total | Share (%) |
|------------|-------|-------------------|----------------|-------------|-------|-----------|
| Category A | 619 | 56 | 254 | 281 | 1,210 | 44 |
| Category B | 750 | 50 | 125 | 155 | 1,080 | 40 |
| Category C | 353 | 8 | 19 | 58 | 438 | 16 |
| Total | 1,722 | 114 | 398 | 494 | 2,728 | 100 |

Source: Vietnamese Government

PRSC has flexibly evolved over time in light of Vietnam's changing development needs and priority. PRSC1 has taken over the features of Structural Adjustment Credits under the Washington Consensus type of conditionalities, and the focus of its conditionality was mainly macroeconomic, structural reforms.⁷ PRSC2 has broadened its coverage to social agenda and crosscutting issues, such as governance, reflecting a multidimensional nature of poverty. PRSC3 and subsequent PRSCs have given greater consideration towards the linkage between economic growth and poverty reduction. The "expanded" CPRGS, with additional chapter on the role of large-scale infrastructures has become the base document for PRSC 3, 4 and 5.

PRSC has effectively functioned as a tool for donor assistance, respecting the government's ownership and facilitating alignment with the government policy. The backward-looking⁸ operation of the PRSC process has facilitated the Vietnamese government and relevant donors to constantly monitor and evaluate reform program in a partnership approach. The PRSCs have been functioning as one-stop base for policy dialogue, and playing a significant role as a "coat hanger" by formulating important framework for reform in coordination with relevant stakeholders.

One of the major focuses in relevance is the country "ownership" of the program and reform policies. There is a wide variety of definitions of "ownership" in aid relationships. Since donors can advise and support, but cannot buy, economic reforms, PRSCs and Development Policy Loans are designed to respect the recipient commitment and ownership of reform of the program and policies. Ohno and Ohno (2007) elaborate the concept of ownership in the context of assistance to Vietnam. They argue that the self-help effort principle of Japanese ODA brings in two distinct dimensions of ownership, namely management of donors and management of policy ideas. Vietnam is often cited as a model country of strong ownership to manage donors.

Our definition of ownership here is close to the one proposed by Buitter (2007). Country ownership of the reform programs and policies implies that the programs and policies are supported by the people who own the country⁹. Reflecting the opinions of the people to the program and policies obviously requires strong and effective institutions to coordinate conflicting interests among

⁷ PRSC1 was originally designed as a SAC II. In the course of the preparation of the SAC II, PRSC was introduced as a new lending instrument to support implementation of Vietnam's poverty reduction strategy – Vietnam was finalizing an Interim Poverty Reduction Strategy Paper (I-PRSP), at the same time, it completed the ten-year Socioeconomic Development Strategy Document in early 2001. The World Bank decided to support the implementation of the I-PRSP reform program with a PRSC, rather than the SAC II. (World Bank, PRSC1 ICR, June 27 2003)

⁸ While Structural Adjustment Credits have taken traditional multitranche operations with forward-looking approach, which relied on promises for future actions to justify disbursements, under the PRSC operation, each single-tranche loan under a programmatic approach is approved following actual performance – that is, on the basis of already completed actions – and thus contributes to systematic policy implementation. (World Bank 2005)

⁹ In Vietnam the Communist Party forms the core of such ownership. We do not intend to reveal the core ownership mechanism of reform policy in this paper.

many stakeholders. Vietnamese government has paid considerable efforts to coordinate to own the program and policies for achieving their goal, WTO accession. We investigate this institution for coordination in the next criteria.

Efficacy: Coordination

PRSC funding has covered substantial additional expenditures for the government’s respective reform areas. **Table 3** shows that significant increase in expenditures in the areas of social safety net, health care funds and education budget has taken place. This implies that PRSC funds have given priority consideration in support of pro-poor policy agenda to mitigate the budget burden to the Vietnamese government.¹⁰

Table 3 PRSC funding: cost of reforms

| (US\$ million; estimated) | 2002 | 2003 | 2004 | 2005 | 2006 |
|---------------------------|------|------|------|------|------|
| SOCB Recapitalization | 307 | 292 | 101 | 0 | 0 |
| Social safety net | 2 | 34 | 83 | 178 | 104 |
| Health care funds | 0 | 33 | 46 | 48 | 91 |
| Education budget | 0 | 46 | 160 | 362 | 537 |
| Total | 309 | 405 | 389 | 587 | 731 |

Source: World Bank

While issues related with approval of law, which some policy actions require, is beyond the authority of the Vietnamese government (the executive branch), by and large, outputs have been produced effectively under a certain degree of time pressure based on the PRSC cycle. The Vietnamese government (the executive branch) plays a very important role in the process of formulation of legal documents (both laws and under-law documents), however, it is the National Assembly that gives approval to most laws. As such, delays could happen occasionally, and part of the reasons for the slow reform in the financial sector has been pointed out on this account.

From the transaction cost perspective, effective coordination mechanisms among relevant organizations have been established (within Vietnamese government, among relevant donors, and within Japanese relevant organizations). The Vietnamese government has effectively accumulated experiences in the PRSC process so far. **Figures 5, 6, 7, and 8** in appendix illustrate the coordination mechanisms within the Vietnamese government. The National Steering Committee (NSC), headed by the First Deputy Prime Minister as a Chairman, was established in 2002. The

¹⁰ The benefit of the PRSC from donor perspective is: “Each donor can acquire comprehensive information about Vietnam’s reform initiatives with minimum financing through the PRSC framework. Hence, the rate of return of PRSC would be infinite so long as reform initiatives are moving forward.”

NSC has the authority over the CPRGS implementation and the entire PRSC policy decisions at the highest level. The State Bank of Vietnam (SBV) is the agency responsible for preparation and implementation of the PRSC.

The PRSC Program Coordination Unit (PCU), in particular, has effectively played the role of the one-stop base for policy dialogue and coordination within the government and with the donors. In light of the increasing workload and the importance of the PRSC initiatives, the PCU – a full time coordination unit – was set up under the International Cooperation Department of the SBV since PRSC3 to exclusively take charge of every matter related with the PRSC operations. As mentioned above, PRSC has evolved over time and expanded its coverage to wider range of the economy and society. The administrative costs of the PCU (including salaries for the personnel) have been covered by the assistance from donors.

While transaction costs have increased as growing number donors participate, they have been kept within a manageable level. The process for choosing policy actions and benchmarks has become complicated due to the different areas of priority and interest for each donor. The World Bank, as a focal donor, has incurred most of the burden concerning coordination among donors and with the Vietnamese government. The fact that both the government and the donors working together in a harmonized manner throughout the process have greatly contributed to improve efficiency. The government has strengthened its ownership and become more active in the PRSC process as it accumulated experiences.

Coordination within the Japanese relevant organizations has been taken place with full utilization of the ODA Task Force at the field level (Embassy, JBIC, JICA and JETRO). In addition to a close communication between the field side and the Tokyo side, coordination has been taken place among the relevant Ministries and JBIC/JICA headquarters in Tokyo.

The fact that Vietnam has been implementing PRSC constantly every year has shown that workable PRSC process has been progressing in Vietnam (see [Table 4](#)). In the cases of other countries in Asia, transaction costs are likely to be huge for constant implementation of the PRSC. In fact, Vietnam has been considered as a role model from other country for PRSC good practice. Missions from the Laotian government have visited Vietnam twice to learn Vietnam's PRSC experiences.

Table 4 PRSCs in International Perspective (for Asian countries)

| Region | Country | FY01 | FY02 | FY03 | FY04 | FY05 | FY06 | FY07 |
|------------|-----------|-------|--------|------|------|------|-------|------|
| East Asia | Cambodia | | | | | | | 1 |
| | Lao PDR | | | | | 1 | 2 | 3 |
| | Vietnam | 1 (I) | 1 (II) | 2 | 3 | 4 | 5 | 6 |
| South Asia | Nepal | | | | 1 | | | |
| | Pakistan | | | | | 1 | 1 [+] | |
| | Sri Lanka | | | 1 | | 2 | | |

Source: World Bank materials

Effectiveness: Integration

While progress has been slower in financial sector reform, in general, reform process has been moving forward as expected. In the case of financial sector reform, there are challenges in securing coherence among legal documents, which can be considered as part of the reasons for delay.¹¹

Table 5 summarizes the progress of development outcomes for PRSC3, 4 and 5. The information in the column of status was drawn from the Implementation Completion and Results Report (World Bank 2007).

Table 5 Progress towards development outcomes

| Indicators | Baseline (2003) | Target (2006) | Status |
|---|--|----------------------------|---|
| Public financial management: Operation and maintenance costs are fully taken into account | U: Unsatisfactory (Limited progress) | Improve from U | Satisfactory: Ban on public investment projects without proper funding. Medium Term Expenditure Frameworks (MTEFs) better integrate capital and recurrent expenditure in four sectors ¹² |
| Planning process: Substantially improved integration of the Public Investment Program (PIP) with budget | S: Satisfactory (Expansion of CPRGS to infrastructure) | Maintain or improve from S | Satisfactory: Improved criteria to prepare, appraise and implement public investment projects leading to better selection and more transparent funding |
| Private sector development: A level playing field secured with same regulations for all | U: Unsatisfactory (Limited progress) | Improve from U | Satisfactory: New land Law improves access to land Corporate tax unified. |

¹¹ A major breakthrough in this reform area was the success of Vietcombank's initial public offering (IPO). Ironically the situation of stock market in Vietnam worsen after the IPO by the sub-prime shock from international market.

¹² Four sectors refer to: education, agriculture and rural development, health, and transport.

| | | | |
|---|--|-----------------------------|--|
| firms | | | |
| SOE reform: There are about 2,100 SOEs | PS: Partially Satisfactory (decreased from 5,334 SOEs in 2001 to 4,361 SOEs in 2003) | Maintain or improve from PS | Satisfactory: About 2,000 SOEs. Large SOEs being transformed. SOE shares sold through auctions. |
| Financial sector reform: SBV focused on supervision and regulation | U: Unsatisfactory (Conflicting SBV responsibilities as owner and regulator) | Improve form U | Partially Satisfactory: Banking reform roadmap approved to remove conflicts and focus SBV on supervision. |

The important issue concerning effectiveness is how to secure adequate enforcement on the ground, after the framework for reform (e.g., legal documents) has been established. The PRSC can facilitate reform process by setting appropriate milestones and policy measures such as implementation guidelines.¹³ However, limitations exist as the PRSC cannot be considered a panacea for every reform (see “**Functional sustainability**” of PRSC mechanism).

In relation to Japan-Vietnam Joint Initiative to improve business climate, although it is difficult to trace the attribution, the increase in investment (in total and from Japan, respectively) has coincided with the PRSC assistance period (see **Figures 9 and 10**). It should be noted that the increasing investment trend started around 2000, when Vietnam has decided to strengthen trade integration with the aim to become a WTO member. In fact, WTO accession was one of the conditions in the US-Vietnam Bilateral Trade Agreement, which was concluded in July 2000. As such, the direction of Vietnam’s reform initiatives has been set at the time. In fact, PRSC policy actions have been consistent with WTO compliance, and the PRSCs may well be considered as one of the available tools to support Vietnam’s WTO accession. Accordingly, Vietnam has increased its attractiveness as a destination for investment, since potential investors may have perceived the investment risks to come down.

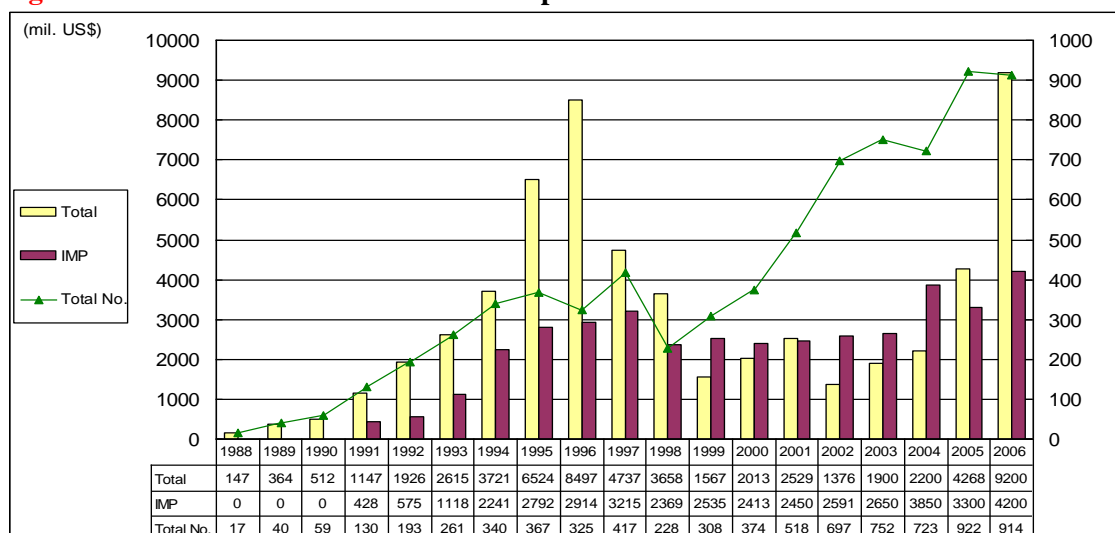
One of the breakthrough achievements, pointed out by Japanese investors in Vietnam, was the “elimination of unanimous or consensus rule” under the new Enterprise Law. Many Japanese investors have recognized this restrictive investment rule as a serious bottleneck. While enforcement issues still remain, there are big expectations on the side of the investors for improvement in a real sense.

We argue that the effectiveness of the PRSCs largely depends upon the Vietnam’s own commitment to push forward for further integration into the global economy. Outside resources and ideas which do not conflict much with domestic interests are appropriated, while a particular set of reforms which were expected to generate a severe conflict between foreign and domestic interests such as SOE reform and financial sector reform delayed. It was because the Vietnamese government

¹³ For example, a number of decrees provide guidelines for implementing the new Enterprise Law and Investment Law.

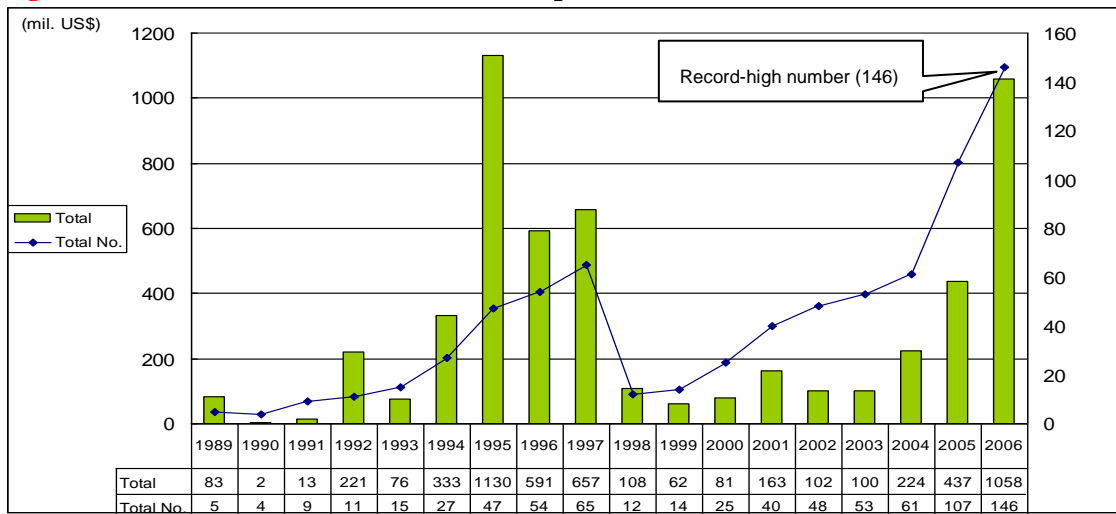
consists of a highly decentralized, fragmented and sometimes incoherent set of state institutions (Painter 2005). To cope with wide range of issues for reforms, the Vietnamese government used foreign aid as a coordination tool, created an internal coordination mechanism as a counterpart of foreign aid which functioned to integrate various set of state institutions. To state more concretely as an example, the Vietnamese government may well have utilized the PRSCs to legitimize reform process to domestic stakeholders by showing that donors are also in support, and to facilitate reform process. The government has been also conscious about the external audiences. By showing the PRSC process has been moving forward, the government has intended to provide potential foreign investors a sense that Vietnam has been truly committed to reform. In fact, Vietnam has increased its attractiveness as a destination for investment. Hence, we can see that the Vietnamese government has been managing the entire reform process with strong ownership, and using foreign aid as its integral part. In this sense, foreign aid did not create strong incentive for reform. Rather it worked as an outside tool creating coordination mechanism for domestic interests.

Figure 9 Increase in investment in PRSC period



Source: JICA expert

Figure 10 Increase in investment in PRSC period



Source: JICA expert

With regarding effectiveness on the part of Japan’s aid practitioners, PRSC has lead to formulate and implement concrete projects and programs to support reform process on the ground by strengthening capacity and facilitating institution building, which in turn provides further toolkit of reforms for various state institutions.

Table 6 shows some specific examples of cases that policy dialogue under the PRSC framework has let to generate opportunities for project/program formulation. Supporting policy reform under the PRSC framework and supporting individual projects/programs will have reinforcing impact with each other. PRSC policy dialogue has lead to implementation of concrete projects and programs to support reform process on the ground.

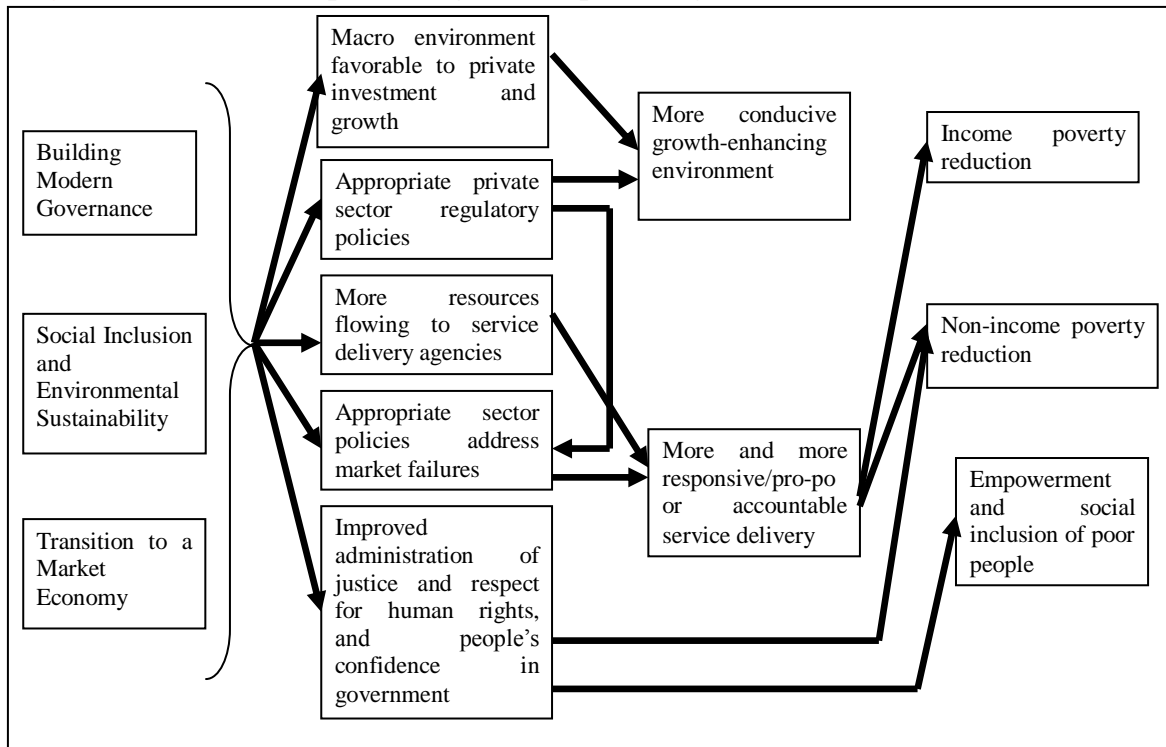
Table 6 Availableness to generate opportunities for project/program formulation

| Policy measures taken up at the PRSC policy dialogue (examples) | JICA projects/programs | JBIC projects/programs |
|--|--|---|
| Issues for enhancing transparency of Development Assistance Fund (DAF) | Preparation of a technical cooperation project underway for SBV capacity building | A study underway for the preparation of action plans to strengthen risk management system of the Vietnam Development Bank |
| Traffic safety issues | Development study on National Road Traffic Safety Master Plan underway | Northern Vietnam National Roads Traffic Safety Improvement Project underway |
| Adoption of regulations for master and regional plans | Development study on Master Plan for the Improvement of Rural Living Conditions in North Western Mountainous Region underway | Small-Scale Pro-Poor Infrastructure Development Project (III) to be prepared for implementation |
| Preparation of pilot MTEF for transport sector | Support provided through activities (Co-chairs: MOT and JBIC) | Transport Partnership group |

Impact: Opportunities for growth and poverty reduction

Figure 11 shows the conceptual diagram on the linkages between outcomes and impacts. Outcomes are the three pillars of the PRSC: (1) Transition to a Market Economy, (2) Social Inclusion and Environmental Sustainability, (3) Building Modern Governance. The diagram was drawn from the causality map in the Joint Donor Evaluation report.

Figure 11 Outcome-Impact linkages (conceptual diagram)



Growth impact

Vietnam has made remarkable achievements in economic growth and firm accomplishments in poverty reduction. And such records have been consistent with the increasing trend of investment to Vietnam. The Vietnamese economy has continued to develop in a robust manner, exceeding 7 percent GDP growth per year from 2002 to 2004, and over 8 percent growth since 2005. Foreign Direct Investment (FDI) inflows, boosted by Vietnam’s accession to the WTO, have surged (see **Figure 12**).

Figure 12 Key economic indicators

| | 2002 | 2003 | 2004 | 2005 r/ | 2006 e/ | 2007 p/ | 2008 p/ |
|---|--------|--------|--------|---------|---------|---------|---------|
| | Year | Year | Year | Year | Year | Year | Year |
| Output, Employment and Prices | | | | | | | |
| GDP (% change previous year) | 7.1 | 7.3 | 7.8 | 8.4 | 8.2 | 8.3 | 8.2 |
| Industrial production index (% change, previous year) | 14.5 | 15.5 | 16.0 | 17.2 | 17.0 | 17.5 | 17.5 |
| Unemployment rate (% , urban areas) | 6.0 | 5.8 | 5.6 | 5.3 | 4.4 | 4.0 | 4.0 |
| Consumer price index (% change, period-end) | 4.0 | 3.0 | 9.5 | 8.4 | 6.6 | 8.0 | 7.3 |
| Public Sector | | | | | | | |
| Government balance (% GDP, excluding off-budget item) | -1.4 | -1.2 | 0.9 | -1.2 | -0.3 | -3.4 | -2.1 |
| Domestic public sector debt (accumulated, % GDP) (including guaranteed and off-budget items) | 10.1 | 13.7 | 15.4 | 17.4 | 18.6 | 19.4 | 20.8 |
| Foreign Trade, BOP and External Debt | | | | | | | |
| Trade balance (\$US million) | -3,027 | -5,107 | -5,451 | -4,531 | -5,010 | -7,822 | -8,922 |
| Exports of goods, (\$US million) | 16,706 | 20,176 | 26,485 | 32,447 | 39,826 | 47,393 | 56,398 |
| Exports of goods (% change, previous year) | 11.2 | 20.8 | 31.3 | 22.5 | 22.7 | 19.0 | 19.0 |
| Key exports, (value, % change) - crude oil | 4.6 | 16.8 | 48.3 | 30.3 | 12.1 | -10.0 | 0.0 |
| Imports of goods, (\$US million, cif) | 19,733 | 25,256 | 31,954 | 36,978 | 44,836 | 55,215 | 65,320 |
| Imports of goods (% change, previous year) | 22.1 | 28.0 | 26.5 | 15.7 | 21.2 | 23.2 | 18.3 |
| Current account balance (\$US million) | -670 | -1,930 | -1,565 | -500 | -165 | -2,200 | -2,560 |
| Current account balance (percent GDP) | -1.9 | -4.9 | -3.4 | -0.9 | -0.3 | -3.2 | -3.2 |
| Foreign direct investment (inflows, US billion) | 2.0 | 1.9 | 1.9 | 2.0 | 2.4 | 2.8 | 3.2 |
| Total external debt -DOD- (\$US billion) | 12.3 | 13.4 | 15.3 | 17.1 | 18.4 | 21.3 | 24.0 |
| as percent of GDP | 35.0 | 33.8 | 33.5 | 32.2 | 30.2 | 30.8 | 30.2 |
| Debt service ratio (% exports of g&s) | 8.3 | 7.5 | 6.0 | 5.6 | 5.3 | 5.5 | 5.6 |
| Reserves, including gold (\$US billion) | 3.7 | 5.6 | 6.3 | 8.6 | 11.5 | 19.9 | 23.6 |
| Reserves (in weeks of imports of g&s) | 7.2 | 8.7 | 8.4 | 9.4 | 10.4 | 15.2 | 15.5 |
| Financial Markets | | | | | | | |
| Credit to the economy (% change, period-end) | 22.2 | 28.4 | 41.6 | 31.7 | 25.4 | 30.0 | 25.0 |
| Short-term interest rate (3-M deposits, period-end) | 7.0 | 6.3 | 6.7 | 7.8 | 8.3 | 8.3 | 8.0 |
| Stock market - VN index (Jul 2000 =100) | 183 | 167 | 239 | 308 | 754 | --- | --- |

Sources: GSO, SBV, IMF and WB

Poverty impacts and governances

Positive changes are also seen in the social development with the rate of poverty headcount reduced to 19.5 percent in 2004 (see [Figure 13](#)). Vietnam has already achieved four of the ten main MDG targets set for 2015, and likely to achieve five more targets ahead of time (see [Figure 14](#)). Vietnam's role in the international arena has been improved, and Vietnam has become an economy with enormous prospects for development and an attractive destination for foreign investors. (MPI, World Bank) .

For the impacts on governance, we can assess the two representative indicators for governance, Polity IV and Worldwide Governance Indicators by Kaufman and Kraay. Authority trends from Polity IV do not have any significant changes in governance because there was no change in the structure of government in the program period. KK index shows a slight improvement in governance, especially in the areas of government effectiveness and rule of law ([Figure 15 and 16](#)).

Figure 13 Trends in poverty

| Poverty headcount | 1993 | 1998 | 2002 | 2004 |
|-------------------------------|------|------|------|------|
| North East | 86.1 | 62.0 | 38.4 | 29.4 |
| North West | 81.0 | 73.4 | 68.0 | 58.6 |
| Red River delta | 62.7 | 29.3 | 22.4 | 12.1 |
| North Central coast | 74.5 | 48.1 | 43.9 | 31.9 |
| South Central coast | 47.2 | 34.5 | 25.2 | 19.0 |
| Central Highlands | 70.0 | 52.4 | 51.8 | 33.1 |
| South East | 37.0 | 12.2 | 10.6 | 5.4 |
| Mekong delta | 47.1 | 36.9 | 23.4 | 15.9 |
| Kinh and Chinese population | 53.9 | 31.1 | 23.1 | 13.5 |
| Ethnic minorities | 86.4 | 75.2 | 69.3 | 60.7 |
| All of Vietnam | 58.1 | 37.4 | 28.9 | 19.5 |
| All of Vietnam (food poverty) | 24.9 | 15.0 | 10.9 | 7.4 |

Note: GSO and World Bank staff estimates. The poverty headcount indicates the percentage of the population with expenditures below the food and non-food consumption bundle needed to sustain an intake of 2100 calories per person per day. The food poverty rate refers to expenditures below the value of the food component of that bundle.

Figure 14 Progress towards the Millennium Development Goals

| Goal 1 | Eradicate extreme poverty and hunger | Progress | Status |
|-----------|---|--|-----------------------|
| Target 1 | Halve between 1990 and 2015 the proportion of people living in poverty | Poverty reduced by two thirds between 1993 and 2004 | Already achieved |
| Target 2 | Halve between 1990 and 2015, the proportion who suffer from hunger | Proportion reduced by more than two thirds between 1993 and 2004 | Already achieved |
| Goal 2 | Achieve universal primary education | Progress | Status |
| Target 3 | By 2015 boys and girls to complete a full course of primary schooling | Grade 5 completion rate has risen has reached 89 percent | Likely to be achieved |
| Goal 3 | Promote gender equality | Progress | Status |
| Target 4 | Eliminate gender gaps in primary and secondary education no later than 2015 | Gender equality at all school levels, except for ethnic minorities | Already achieved |
| Goal 4 | Reduce child mortality | Progress | Status |
| Target 5 | Reduce by two thirds between 1990 and 2015, the under-five mortality rate | Reduced by 60 percent between 1990 and 2002, now at 23/1000 | Likely to be achieved |
| Goal 5 | Improve maternal health | Progress | Status |
| Target 6 | Reduce maternal mortality by three quarters, between 1990 and 2015 | Fell by two thirds, from 250 per 100,000 births in 1990 to 85 now | Likely to be achieved |
| Goal 6 | Combat HIV/AIDS and other diseases | Progress | Status |
| Target 7 | By 2015 have halted and begun to reverse the spread of HIV/AIDS | Infection rate went up from 0.34 percent in 2001 to 0.44 in 2005 | Likely to be achieved |
| Target 8 | By 2015 halted and reverse the incidence of malaria and other diseases | Malaria cases severely reduced | Already achieved |
| Goal 7 | Ensure environmental sustainability | Progress | Status |
| Target 9 | Embrace sustainability and reverse the loss of environmental resources | Forest cover up but loss in closed-canopy forest and biodiversity | Uncertain to achieve |
| Target 10 | Halve, by 2015 the share of people without drinking water and sanitation | Share without improved water source fell by almost three quarters | Likely to be achieved |

Source: United Nations Development Program (UNDP), General Statistics Office (GSO) and World Bank.

Figure 15 Polity IV Authority trends for Vietnam

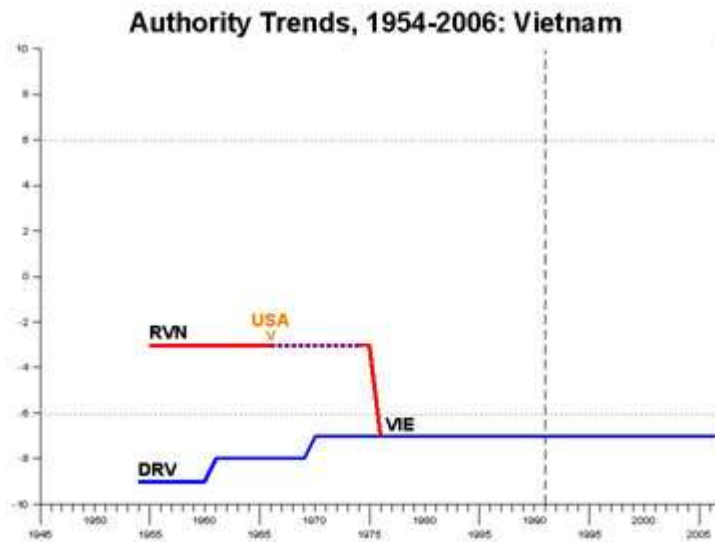
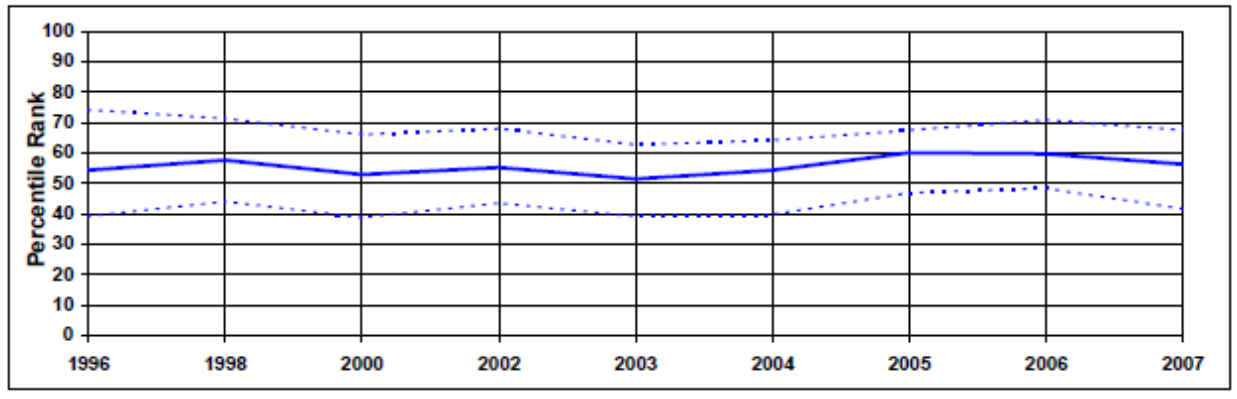


Figure 16 Worldwide Governance Indicators for Vietnam



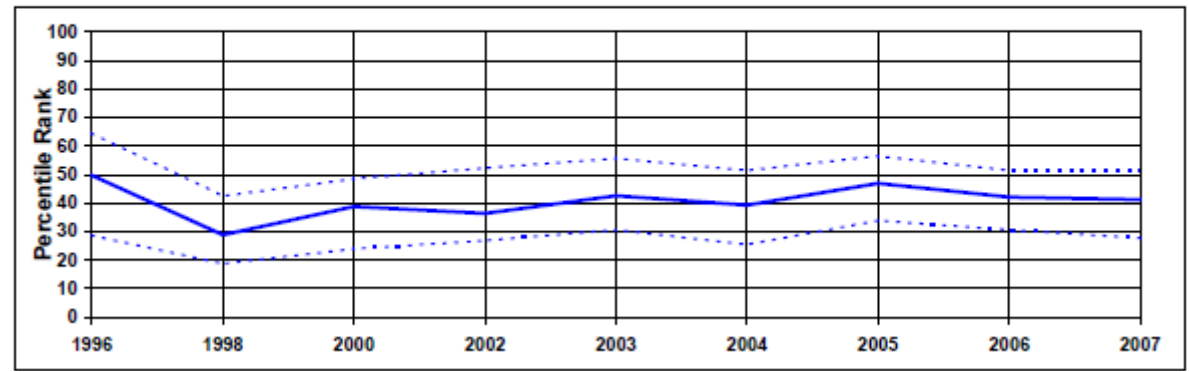
VIETNAM, 1996-2007

Aggregate Indicator: Political Stability and Absence of Violence



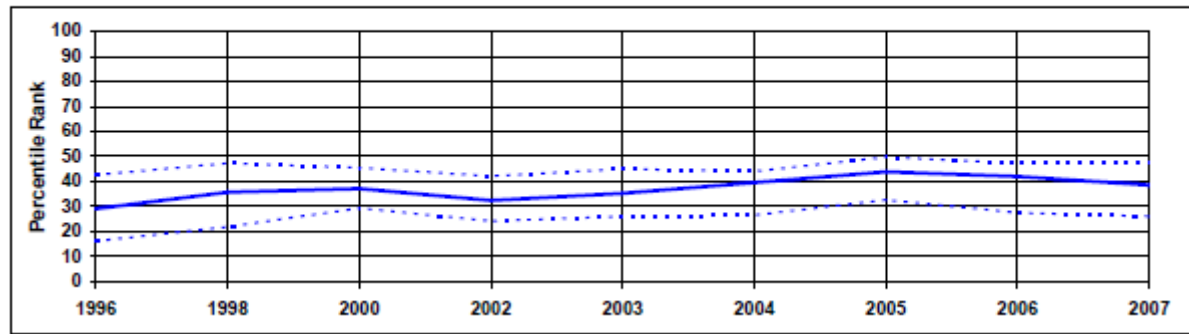
VIETNAM, 1996-2007

Aggregate Indicator: Government Effectiveness

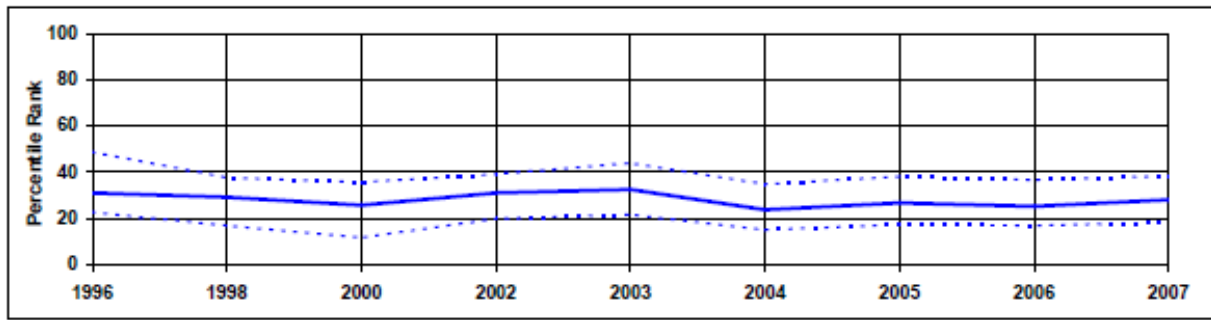


VIETNAM, 1996-2007

Aggregate Indicator: Rule of Law



VIETNAM, 1996-2007
Aggregate Indicator: Control of Corruption



Sustainability: Can they find another vine for “Tarzan” economy?

While PRSC mechanism itself may come to an end with Vietnam’s graduation from the IDA eligible status (most probably after 2011), in order for the effectiveness of PRSC outputs and outcomes to continue in medium and long term, “functional sustainability” of PRSC mechanism becomes a critical factor.

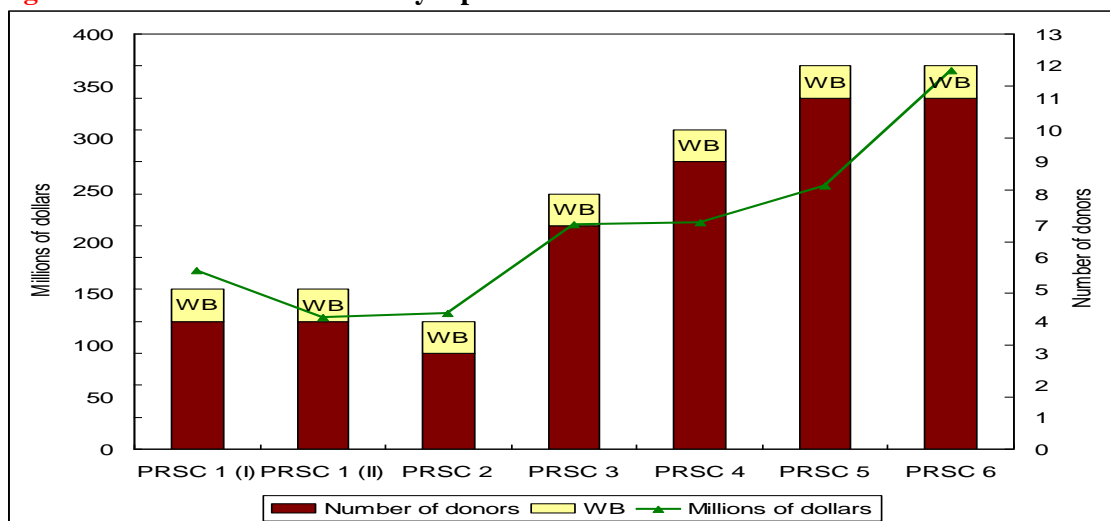
“Function” referred here could be understood as accumulated experiences, knowledge, skills etc., which have been fostered through the past PRSC initiatives by relevant parties. Such function is highly valuable not only for the future PRSC operations *per se*, but also for the Vietnamese government’s overall policy making and reform initiatives in a forward looking manner. The Vietnamese government has translated such function into their daily work – through enhancing communication and coordination mechanisms, and strengthening channels for policy dialogue within the government as well as with donors and investors. Through the PRSC process, the donor side has also strengthened coordination and channels for policy dialogue with the Vietnamese government.

“Sustainability” here refers to whether or not, and to what extent the abovementioned functions would be retained and utilized later on, even without PRSC after Vietnam graduates from IDA. Configuration of donor support corresponding to the post-PRSC mechanism, if any, may change, and the SBV may no longer play the role as a focal point within the government after 2011. In fact, the Vietnamese government may choose some other agencies as focal point to carry over and utilize such accumulated functions. In this sense, “function” and “organization” should be distinguished clearly here – it is the function that needs to be retained and enhanced, not a particular organization itself (e.g., SBV).

Despite the number of donors participating in the (post-)PRSC mechanism may increase in the future, PRSC “function” should continue to be institutionalized and workable, keeping transaction costs for coordination within a manageable level. **Figure 17** shows the total disbursement by operation and the number of co-financiers. As new rounds of the PRSC proceed, disbursement amount and the number of co-financiers have also increased. The fact that Vietnam can continue new rounds of the PRSC constantly has shown that these increasing transaction costs for

coordination have been managed effectively. Hence, the bases for “functional sustainability” of PRSC mechanism can be considered existent.

Figure 17 Total Disbursement by Operation and Number of Co-financiers



Source : World Bank

Through the PRSC experiences, the government has learned how to manage changes to the economy and society. As Vietnam is rapidly undergoing transition to a market economy, effective changes in institutions becomes highly critical. Vietnam is facing a new challenge, and PRSC function should be developed in order for the Vietnamese government to quickly and adequately respond to changing environment in the international market, which Vietnam is more and more exposed to. Post-PRSC needs to address market participants in the international financial market (i.e., external stakeholders), in addition to the existing FDI investors, who have been one of the target audience in the past PRSCs. In fact, true policy stance/fiscal stance needs to be signaled to such external stakeholders in order for the Vietnamese government to effectively manage expectations about the economy¹⁴.

As Vietnam will have more options for funding sources to cover the country’s development needs (especially after 2011), whether the Vietnamese government would still be interested in borrowing from donors in softer terms or rather opt to procure funds from other sources in harder terms would become a question to be noted. The Vietnamese government would give careful consideration to various conditions to decide on the most desirable option – transaction costs for donor coordination could be one of the items that the government would examine. Such being the case, donors may start to consider the strategies for working with middle income country.

The effectiveness of the PRSC outputs and outcomes will be sustained only when they are complemented by appropriate capacity development. As mentioned earlier, the PRSC can not be

¹⁴ Recent problems of high inflation and surge in current account imbalance seem to indicate the deficiencies of the existing institutions.

considered a panacea for every reform. Because PRSC policy actions are the essence of the most important milestones for reform, limitation exists in dealing with step-by-step capacity improvement on the ground – and it is the role of the capacity development to do the job. Therefore, the PRSC needs to be complemented by capacity development for institution building to make real changes. They should go together to exert synergetic effects. Change is driven by political objectives, long-term, and needs constant (re-) negotiations between actors. Such capacity development should support stronger budgeting and planning by facilitation of processes, offering long-term advice to key actors, and supply of technical expertise on demand.

In view of Vietnam's further economic integration, technical assistance should address the needs of market participants in the international financial market. Accordingly, the level of challenge is expected to increase as new round of the PRSC proceeds.

Evaluating from the continuity of Japan/JBIC's participation in the PRSC framework, a Japanese investor noted an important point, in relation to Japan-Vietnam Joint Initiative, that establishing the rule of the game is not the end in itself, but how to ensure its effectiveness is the issue. Japanese investors are eager to see practical gain from the initiatives.

By the same token, preparation of policy actions is not the end in itself in the PRSC initiatives. Actual institutional reform and capacity building at the field are indispensable to achieve real reform. Therefore, JBIC/JICA should provide appropriate technical assistance so as to secure enforcement for real changes and to strengthen PRSC effectiveness and sustainability.

4. Conclusion

Were the PRSCs in Vietnam efficient and effective aid for Vietnamese Economy? Our assessment clearly confirms the success of the PRSCs in Vietnam. The PRSCs in Vietnam were indeed the most successful case of the PRSCs in the world. Our analysis suggests that the key to success were strong ownership of the Vietnamese government, its strong commitment to WTO accession and process beyond, and coordination institutions that have enabled to implement the reform process effectively. The PRSCs have indeed supported these key factors and contributed to facilitate the country's overall reform process.. The Vietnamese economy has continued to grow strongly, exceeding 7 percent GDP growth per year from 2002 to 2004, and over 8 percent growth since 2005. Positive changes are also seen in the social development with the rate of poverty headcount reduced to 19.5 percent in 2004. While progress has been slower in financial sector reform, in general, reform process has been moving forward as expected. With respect to the initiatives to improve business climate, the increase in investment has coincided with the PRSC assistance period. Furthermore, the PRSC has lead to formulate and implement concrete projects and programs to support reform process on the ground by strengthening capacity and facilitating institution building. As for the transaction costs required, effective coordination mechanisms among relevant organizations have been established (within Vietnamese government, and among relevant

donors). While transaction costs have increased as growing number donors participate, they have been kept within a manageable level.

Then, did the PRSCs create incentives for institutional reform in Vietnam? Generally our assessment is very conservative. Vietnam's strong commitment and ownership of reform program and policies are fundamentally based on the motivation of integration to the global economy. WTO accession provided a great push toward market economy. The PRSCs and technical assistance from donors can be mutually enforced through various stages of policy action. Technical assistance can bring about policy agenda that has been identified on the ground to the PRSC policy dialogue. Concurrently, technical assistance can enforce specific actions that have been addressed during the policy dialogue in the PRSC framework.

The sustainability of reform mechanism in Vietnam after 2011 poses a very difficult issue. The experience of China offers a good example of the change in policy space after accession to WTO. Heilman (2008) reported the range of policy experimentation in China substantially narrowed after its accession to WTO membership. Although the context of Vietnam is somewhat different from that of China, these two economies share the some characteristics in common. To cope with the rapidly changing international economic environment, the PRSCs have functioned to effectively communicate with various donors and other development partners. In light of the evolution of the PRSC mechanism and policy agenda (e.g., coverage has become comprehensive – from macroeconomic, structural reforms to a broader reform agenda), the Vietnamese government clearly needs some institutional mechanism for policy coordination and enforcement to continue on its reform process under the post-PRSC framework. It will be a real challenge to the Vietnamese economy after 2011 when the role of foreign aid is anticipated to be much narrower.

End.

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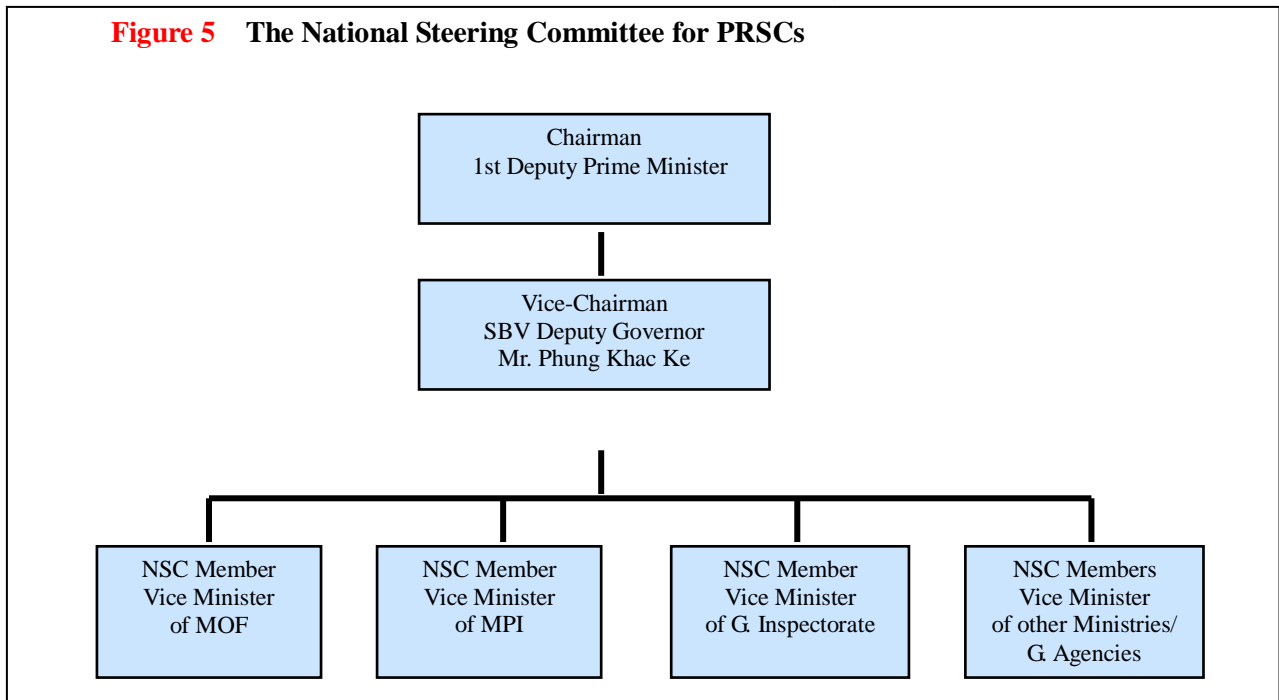
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APPENDIX Coordination institutions within the Vietnamese government

Figure 5 The National Steering Committee for PRSCs



* The National Steering Committee for the implementation of the CPRGS and the PRSCs was established in 2002. The member Vice Minister is appointed by the respective Minister.

Figure 6 The Secretariat for PRSCs

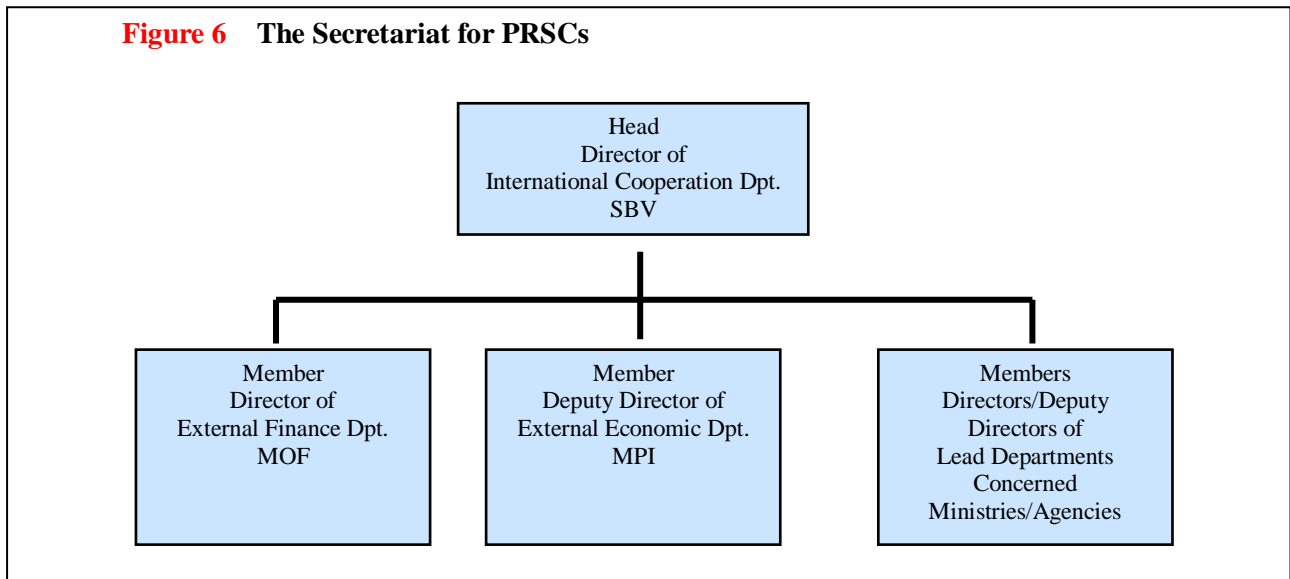
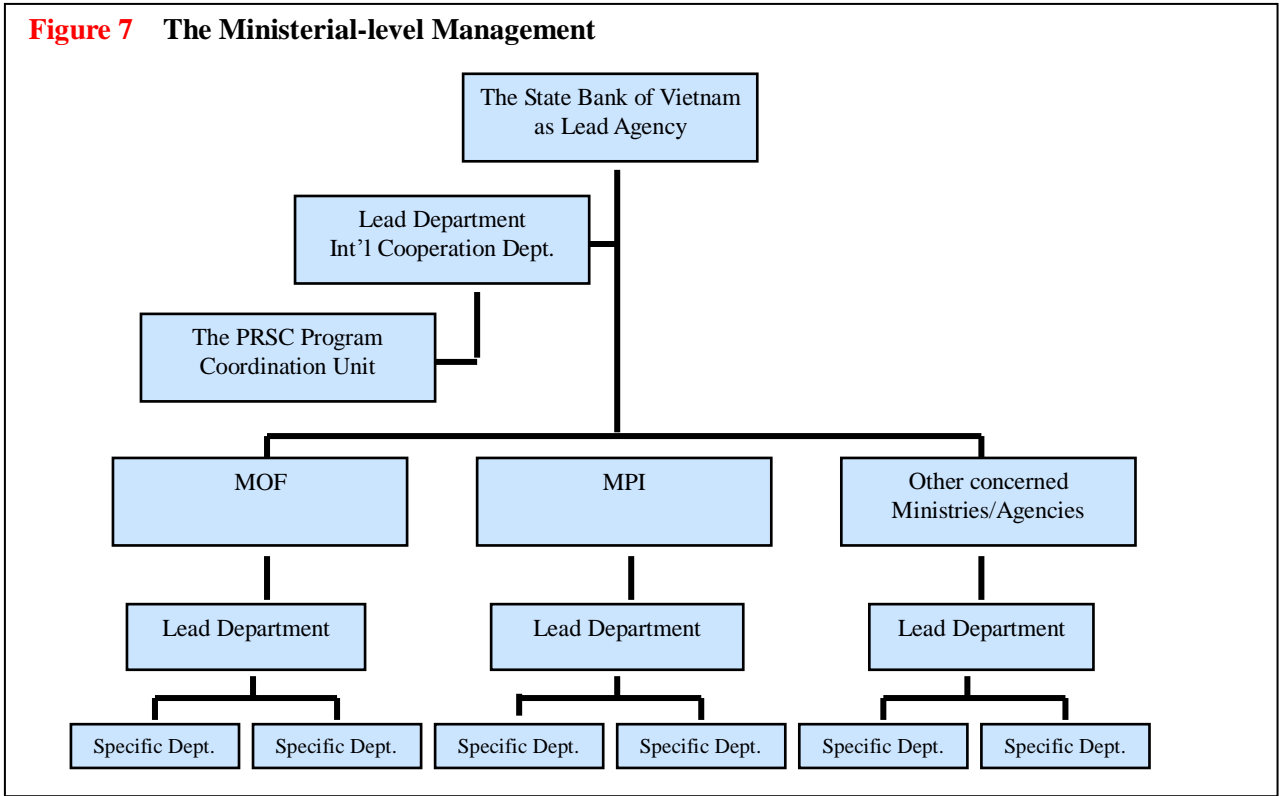
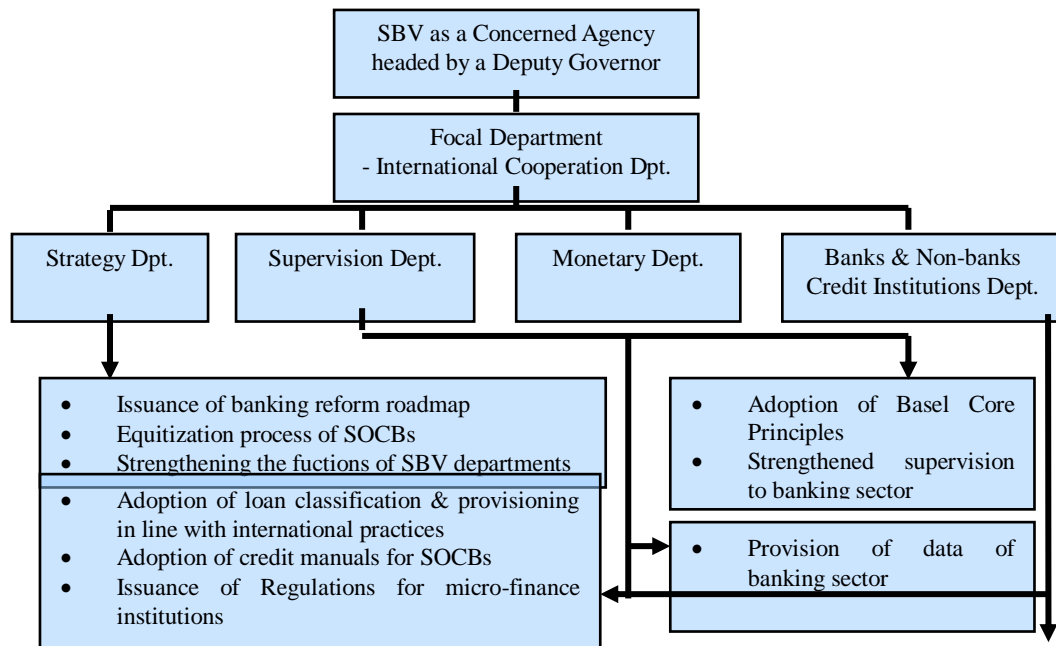


Figure 7 The Ministerial-level Management



* The PRSCs Program Coordination Unit was only established since PRSC 3, but has shown valuable contribution to supporting the broadly concerned ministries in the preparation, implementation and monitoring of the operations and to the coordination between the Government and the World Bank & other donors.

Figure 8 SBV's participation in THE PRSCSs



(Sources of all the diagrams SBV PCU)